

Economics 100b, Fall 2005
Sample Midterm Questions
Chapter 12

Aggregate Demand Shock

Suppose for some reason the confidence of the consumers declines.

- (a) How does this shock affect the economy if the policymakers follow the monetary policy rule of $R - r = \bar{m}(\pi - \bar{\pi})$ if this shock is sustained for five years? (Assuming that the economy will finish adjusting and go back to zero output gap exactly in the end of the fifth year and the shock will disappear in the end of the fifth year.)
- (b) How does your prediction of inflation in (a) depend on \bar{m} ?
- (c) How will this economy evolve in the future once the shock disappears five years later?
- (d) Draw the time path diagrams of output gap and inflation for (a) and (c).